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American Banker

The Daily Financial Services Ne

VOL. CLIV NO. 224 Thursday, November 16, 1989 154th Year

NEWSPAPER
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CONGRESSIONAL INFOR SREV SRI
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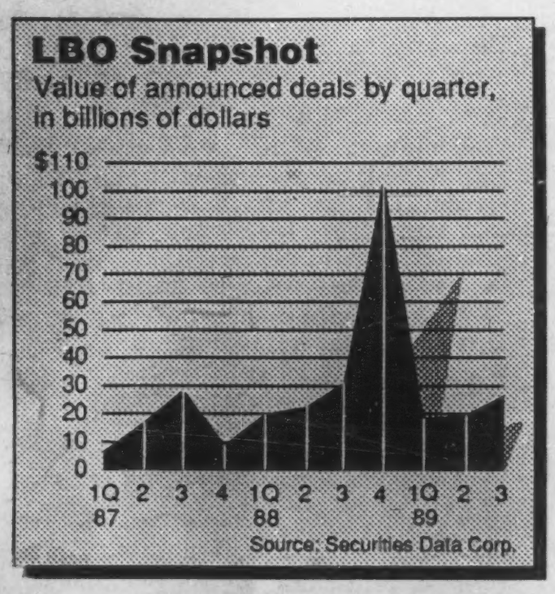


LBO Gloves Are Off As Comptroller Challenges Lenders

By DAVID NEUSTADT

NEW YORK — The Comptroller of the Currency's warning this week on leveraged-buyout loans represents a fundamental change in his attitude toward those transactions.

According to staff members at the Comptroller's office, the turnaround reflects the continued large volume of leveraged buyouts this year, a rapid rise in the number of problem loans, and deterioration in the credit quality of new deals.

NEWS ANALYSIS

In April, Comptroller Robert L. Clarke issued an optimistic report on commercial bank exposure to highly leveraged transactions, or HLTs. On Tuesday, speaking to a convention of corporate lending officers, Mr. Clarke unveiled his new position.

"In the past, the OCC has stated that HLTs did not pose undue risk to the safety and soundness of individual banks or to the banking system," Mr. Clarke told a Robert Morris Associates convention in Atlanta. "But we have

See LBO: Back Page ▸

Farm Credit System Undercuts Banks, Says ABA President

By ROBERT TRIGAUX

WASHINGTON — A running feud between commercial banks and the Farm Credit System flared up again this week as the head of the American Bankers Association charged that the government-sponsored agency was using below-market rates to lure farm borrowers.

"The Farm Credit System poses a very real threat to banks, and to the economy, so long as it permits the kind of predatory, below-cost pricing we've seen in Omaha, St. Paul, and right here in St. Louis," C.G. Kelly Holthus, the ABA president, said at the industry's annual farm credit convention.

But the chairman of the Farm Credit Administration, which regulates Farm Credit System lenders, rejected the charge.

"I have been assured by our chief examiner that our examinations to date have revealed no evidence that predatory pricing is being practiced by any of the Farm Credit institutions," Harold Steele on Tuesday told 600 farm bankers and industry representatives attending the ABA's annual agricultural credit convention in St. Louis. Convention remarks by both Mr. Holthus and Mr. Steele were released in Washington.

The Farm Credit Council, which lobbies for the Farm Credit System, called the ABA complaints "absurd" and said there were no complaints by farmers about interest rates.

Sharp competition between commercial banks and Farm Credit System institutions to win the business of farmers is hardly new. But the strong recovery of the agricultural sector – after the mid-1980s failure of hundreds of farm banks and the bailout of the Farm Credit System – has revived animos-

See ABA: Page 14 ▸

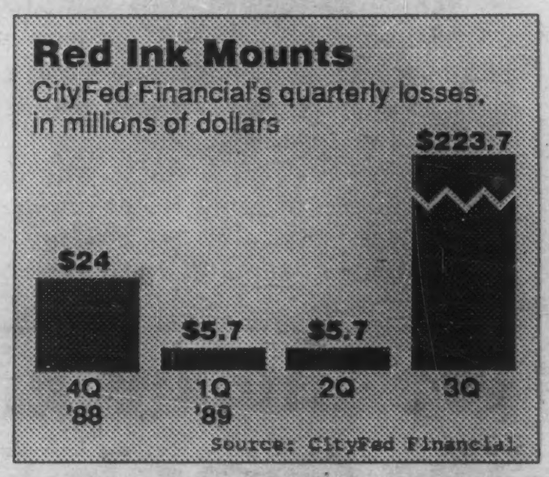
CityFed Chief Admits Thrift May Face Seizure by Regulators

By REBECCA COX

NEW YORK — The chief executive officer of CityFed Financial Corp., one of the nation's largest thrifts, acknowledged on Wednesday that the ailing New Jersey company may be close to a takeover by federal regulators as its losses mount from real estate development loans.

The statement by John W. Atherton accompanied the disclosure of a third-quarter loss of $223.7 million, equal to $11.75 a share, for the Somerset-based holding company.

The losses were caused mostly by bad construction and development loans in New Jersey, other Middle Atlantic states, and Florida, according to Michael J. Rust, director of corporate relations. CityFed's real estate portfolio began to turn sour in 1987, contributing to losses for the past four consecutive quarters. The third-quarter figure is almost 10 times the previous record loss of $24 million in the last quarter of 1988.



Its cumulative loss through nine

See LOSSES: Page 14 ▸

Lincoln Auditor: Tainted, but Not Charged

By JIM McTAGUE and JOHN FORDE

After weeks of top billing in the Lincoln Savings scandal, real estate magnate Charles H. Keating Jr. and the five U.S. senators who pleaded with regulators to go easy on him are being pushed off center stage by a supporting character – the accounting firm of Arthur Young & Co.

NEWS ANALYSIS

The firm, in the course of five House Banking Committee hearings on Lincoln Savings and Loan Association, has been vilified by federal regulators for allegedly hiding the thrift's losses with creative bookkeeping. And it has been blamed by the so-called "Keating Five" senators for convincing them that Lincoln was being persecuted by former Federal Home Loan Bank Board Chairman Edwin Gray, necessitating their help.

Kenneth Leventhal & Co., a competing accounting firm hired by the regulators to look at 15 real estate deals done by Lincoln, concluded that the Irvine, Calif., thrift had used "cookbook rules" to justify nonexistent profits. The report did not specifically fault Arthur Young's performance, however, as Leventhal reportedly never looked at audit statements.

And Richard Breeden, new chairman of the Securities and Exchange Commission, testified that Arthur Young was uncooperative with his agency, which has been investigating bond offerings by Lincoln's parent, American Continental Corp. of Phoenix.

See LINCOLN: Page 15 ▸

Today

First Bank System halved its quarterly dividend and disclosed that the bank's board has a list of CEO candidates. 2

Charles R. Rinehart, H.F. Ahmanson & Co.'s incoming president, believes in focusing on a company's best business. 2

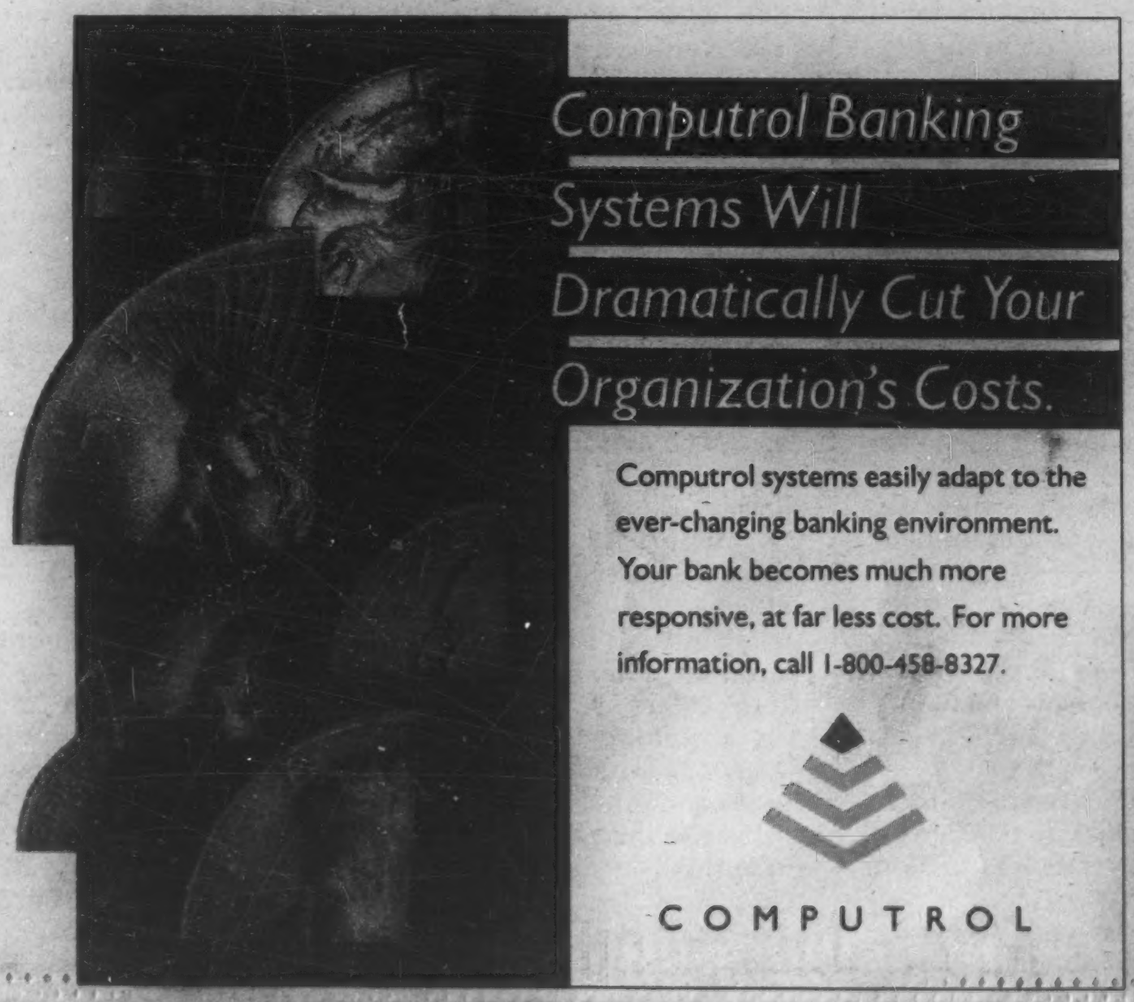
West German banks are expected to take the lead in seeking new business in East Germany. 2

Banks that build information systems to support new ventures such as trade finance will fare best in the global market, industry experts said. 3

BSD Bancorp, San Diego, is spinning off its data processing subsidiary. 3

Even though banks have been fined for not reporting large cash transactions, lawyers are refusing to provide the data in the name of client confidentiality. 2

Consumer Services 6
People 8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COMMENT

Will Top Banks Get a Break on Deposit Insurance?

By IRVINE SPRAGUE

Taking a haircut" will become the buzzwords over the next six months as the fight heats up over how best to revise the federal deposit insurance system.

This is the shortcut language for the big bank proposal to insure all domestic deposits up $100,000 and then cut the protection – perhaps by 15% – for deposits over the insured limit. Alternative proposals would reduce the $100,000 to a lower figure or cut the protection to something less than 100% on all deposits.

All in the name of market discipline.

The ploy is aimed at distracting criticism over the "too big to fail" doctrine, which states that really big institutions have not been and will not be allowed to close their doors. Stockholders may take a hit, but all depositors and other creditors are fully protected in the money-center banks.

Recently, in speaking to the National Bureau of Economic Research in Cambridge, Mass., I encountered a new theory put forward by some of the economists. Deposits at large banks, they suggested, are protected by the too-big-to-fail doctrine; depositors at small banks are protected because the institutions have few if any uninsured deposits. Depositors at midsize banks are the only ones at risk, the economists argue.

The Citibank theory, and others resembling it, is that under the the haircut proposal, all banks would be treated alike: big, midsize, and small.

There is just one flaw in this reasoning. A fatal one.

'Savvy depositors, those with big dollars, will know that giant banks do not fail, so they will move their money away from banks that would be exposed to the haircut to those that would not.'

— Irvine Sprague

Savvy Depositors Know Better

The goal of equal treatment sounds wonderful. The problem is that savvy depositors, those with big dollars, will know that giant banks do not fail, so they will move their money away from banks that would be exposed to the haircut to those that would not.

The second big debate should be over the assessment of foreign deposits and deposit-like instruments. The present system is a disgrace as it provides 100% insurance protection for all depositors and creditors in the big banks yet allows them to escape payment for much of this protection. In some cases, the insurance bill is for less than half of the protection.

One could argue that there is nothing in law or regulation, nothing written anywhere, that says that the giant banks should not be allowed to fail. It is simply a fact of life. Continental Illinois taught us this. The largest bank ever to be allowed to fail, and its depositors allowed to lose, was Penn Square, a $30 million shopping center bank that grew in short order to $500 million through some very dubious dealings.

Let's spell it out in simple terms:

Small banks basically depend on two sources of funds: deposits and capital. Large banks, on the other hand, use a wider variety of funding sources, including nondeposit borrowings and deposits raised in overseas offices. Thus, the small banks pay insurance premiums assessed against virtually all their funding base, while the largest banks, which receive far broader protection, pay premiums on a much narrower portion of their funding base.

Virtually all of the foreign deposits are in the money-center banks but there are 270 in all with some such deposits. If we assess and insure foreign deposits, it would cause complications if one of the smaller banks with foreign deposits were allowed to fail, but not complications of such significant nature as to override the need for fairness.

While writing my 1986 book "Bailout," I ordered a computer run of the mix of domestic and foreign deposits in the money-center banks. After passage of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, I asked that the tables be run again.

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Mr. Sprague served as chairman or director of the Federal Deposit Insurance Corp. for more than 11 years, during which time he handled 374 bank failures. He is the author of the 1986 book "Bailout: An Insider's Account of Bank Failures and Rescues."

The Lobbyists

By Barbara A. Rehm

ABA Group Seeks Smoother Access To Loan Resales

The **American Bankers Association** has formed a group in the hope of opening doors to the secondary markets. Bankers are seeking ways to move assets off their balance sheets and thus want more access to these markets.

As a first step, members of the ABA secondary-market liaison subcommittee met last week with senior lenders from two government-sponsored agencies that make a secondary market for mortgages, the Federal National Mortgage Association and Federal Home Loan Mortgage Corp.

The group wants Fannie Mae, Freddie Mac, and other agencies to detail what they require of loans before they are securitized. For example, what environmental-hazard criteria must banks follow for their loans to pass the agencies' muster?

Kevin F. Walsh

"Many banks do not think that they have the volume to warrant participation," said **Kevin F. Walsh**, the group's chairman and executive vice president at NBD Illinois Inc. "However, the secondary market is willing to work with banks in communities that can generate $1 million a month in residential production."

Mortgage Insurers Say FHA Will Lose on Bigger Loans

The **Mortgage Insurance Companies of America**, taking the offensive against higher loan limits on FHA-insured mortgages, said this week that larger loans produce larger losses for insurers.

After Congress voted to increase the Federal Housing Administration's loan limit for one year, Rep. **Gerald D. Kleczka**, D-Wis., asked the **General Accounting Office** to study its impact. GAO in turn asked the insurers' group for data on losses produced by mortgages greater than $90,000, the former cap on FHA loans. The FHA may now insure loans made on homes up to 95% of the median sale price.

Congress was attracted to the hike in the FHA's loan limit because it would increase FHA premium revenues next year by an estimated $50 million, but the group's president, **William H. Lacy**, said any gain would be buried by the losses FHA will suffer.

Mr. Lacy, at a news conference Wednesday, said after analyzing 514,000 mortgage loans that the mortgage insurers group concluded that a $188,000 mortgage is 1½ times more likely to default than a $90,000 mortgage. The group turned over its analysis and the raw data to the GAO.

"Unfortunately some people don't like to see this data," he said. "But we run our companies on this data."

Mr. Lacy acknowledged that it serves his members to keep FHA loan limits capped, but said that it was hard to compete against a government agency that does not operate at breakeven.

Cushman & Wakefield Sees Fertile Ground for Lobbyist

Cushman & Wakefield, the New York-based real estate concern, is deploying senior vice president **Gerald R. Mylroie** to lobby the Resolution Trust Corp.

"Rather than RTC getting 100 phone calls from Cushman & Wakefield brokers, the idea is, they can have one point of contact with me," Mr. Mylroie explains.

His goal? Drum up business for Cushman & Wakefield. Mr. Mylroie thinks Cushman & Wakefield can help the RTC manage, appraise, and sell the thousands of real estate assets it will take over from failed thrifts.

Cushman & Wakefield, Mr. Mylroie notes, is the nation's largest non-owner manager of commercial office space. It employs more real estate appraisers than any other company, ranks third in sales agents, and has vast experience selling property, he says.

Gerald R. Mylroie

Mr. Mylroie also expects to run defense. Right now, Cushman & Wakefield is guarding against the RTC's formulating conflict-of-interest rules that prevent any one company from taking multiple roles in the thrift cleanup. Mr. Mylroie is confident that the agency cannot take a hard line. "There's too big a job to do to impose that kind of restraint."

The RTC board plans to take up the ethics issue at a meeting Wednesday.

American Banker
The Daily Financial Services Newspaper

Established 1836
One State Street Plaza, New York, N.Y. 10004
212-943-6700

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The American Banker is published daily, except Saturday, Sunday, and holidays, by American Banker • Bond Buyer.
Subscription rates: U.S. $555 a year; Canada $815; Canada Airmail and Foreign $1,120.
Wires: WU Telex 882385 Answer Back: AmerBank NYK. WUI 62594 AMERBANKER
Cable Address: AMERBANKER New York.
Telecopier: 212-943-2222

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COMMENT

Will Big Banks, as Usual, Get a Break in Deposit-Insurance Reform?

▶ Continued from Page 4

Surprise. Nothing had changed. The same big banks continue to get their free ride.

This time, John Quinn, the FDIC's chief of banking statistics, added a new column to the table and it is most revealing. Domestic office non-deposit liabilities, excluding subordinated debt, show a pattern of free-ride protection that almost equals that in the foreign deposit column.

In the past, I have heard no one who would argue that a free ride on foreign-deposit protection is fair, but somehow this fairness doctrine is never converted into legislation.

True, the Senate two years ago passed a bill to assess foreign deposits but this was in the context of a budget resolution, and it disappeared in the dark of the night during the conference committee's deliberations.

This history gives some hope that justice will be done this time around. The iron vises of the Gramm-Rudman bill are beginning to bind and the administration and the Congress will be looking for revenues: the Congress to pay its bills, the President to avoid raising taxes.

FDIC income has nothing to do with the federal budget but an anomaly in the budget computations allows the national budget deficit to be reduced by the amount of FDIC income. The numbers should be tempting to the Budget committees.

Ante Has Been Raised

Enormous sums are involved. This is not going to be a fight over dominos or poker chips. The new legislation raised the ante by just about doubling the FDIC insurance assessments over two years.

The current deposit insurance assessment rate of 0.083% of domestic deposits increases to 0.12% in 1990 and to 0.15% in 1991. Assessment credits that were routinely voted for 50 years – sometimes as much as 50% – disappeared the past four years and it is difficult to see them looming on the horizon.

With so much at stake, the lobbying forces are gearing up. The American Bankers Association has assembled a blue-ribbon committee representing banks of all sizes and all geographical regions.

The Independent Bankers Association of America has put together a similar group and beyond that is taking the unprecedented action for Washington

> 'Once the "haircut" language gets to be old hat, the talk will turn to 'market discipline' and 'risk related' premiums, both of which are nonsense.'

in hiring a consumer market-research concern to develop some facts before taking a position.

Dollar Signs in Sight

Treasury is gearing up and the consultants, lawyers, and lobbyists are salivating at the sight of the dollars they will be making.

Once the "haircut" language gets to be old hat, the talk will turn to "market discipline" and "risk related" premiums, both of which are nonsense.

Market discipline has been a dream of many for years and it still gets lip service, even from former regulators who should know better. FDIC chairman Bill Seidman, in the Aug. 30 *Wall Street Journal,* told the story succinctly: "We have a hard enough time figuring out a bank's financial condition. I don't see how you can expect a depositor to do it," he said.

Even More Tricky

Risk-related premiums are even more tricky. Those of you who have had to deal with truth-in-lending rules, with their thousands of pages of regulations, will look back at the experience as a haven of clarity if risk-related rules mushroom.

All in all, it will be an exciting time. The bottom line, of course, if we can count the past as in indicator, is that the big banks will win the fight hands down. What we can hope for is that the national press will cover the lobbying efforts like a blanket and that the local press will hold each senator and congressman to account for his or her vote. ■

Top 10 Banks in Foreign Deposits

Dollars in billions

	Foreign deposits	Domestic deposits	Nondeposit liabilities
1. Citibank	$61.8	$44.2	$19.6
2. Morgan Guaranty Trust	37.1	11.9	10.2
3. Chase Manhattan Bank	33.8	27.7	9.4
4. Manufacturers Hanover Trust Co.	20.1	23.5	7.0
5. Bank of America	20.2	50.6	7.3
6. First National Bank of Chicago	15.1	13.9	5.6
7. Republic National Bank of New York	8.2	5.8	4.5
8. Irving Trust Co.	8.0	7.0	4.7
9. Bank of New York Co.	7.0	11.9	3.8
10. Security Pacific National Bank	6.9	30.4	11.6

Source: June 30 call reports

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